

Memorandum

*Flex your power!
Be energy efficient!*

To: R. GREGG ALBRIGHT
Deputy Director
Planning & Modal Programs

Date: February 14, 2008

File No.: P1170-1978
Agreement No.: Various

From: MARYANN CAMPBELL-SMITH
Chief, External Audits
Audits and Investigations

Subject: Incurred Cost Audit – Coachella Valley Association of Governments (CVAG)

We have audited the costs claimed by and reimbursed to the Coachella Valley Association of Governments (CVAG), totaling \$7,367,566 for the work performed pursuant to Agreements CML-6164(10) and CML 6164(16), with the Department of Transportation (Department) to determine whether the costs are adequately supported and in compliance with the Agreement provisions and State and federal regulations. CVAG entered into separate agreements with SunLine Services Group (SSG) to provide Regional PM10 street sweeping services. SSG performed the street sweeping services and billed CVAG per the separate agreements. As a result, we also audited SSG's financial management system to determine whether it is adequate to accumulate and segregate reasonable, allocable, and allowable costs. This audit is performed as a management service to the Department to assist in its fiduciary responsibility to State and federal regulatory agencies. The audit report, including CVAG's responses, is attached.

Please provide our office with a Department action plan related to the audit recommendations within 90 days.

We thank you and your staff for their assistance provided during this audit. If you have any questions or need additional information, please call Teresa Greisen, Audit Manager, at (916) 323-7910 or myself, at (916) 323-7105.

Attachment(s)

- c: Michael A. Perovich, District Director, Department of Transportation, D8
- Terry Abbott, Chief, Local Assistance, Department of Transportation
- Gerald A. Long, Deputy Director, Audits and Investigations, Department of Transportation
- Clark Paulsen, Chief, Division of Accounting, Department of Transportation
- Terry Zanchi, Accounting Administrator, Division of Accounting, Department of Transportation
- John Wohlmuth, Executive Director, Coachella Valley Association of Governments
- Brenda Bryant, Director of Financial Services, Federal Highway Administration

P1170-1978
Incurred Cost Audit Coachella Valley Association of Governments
February 2008

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AUDIT REPORT

SUMMARY

We have audited the costs claimed by and reimbursed to the Coachella Valley Association of Governments (CVAG), totaling \$7,367,566, for the work performed pursuant to Agreements CML-6164(10) and CML-6164(16) between the Department of Transportation (Department) and CVAG, to determine whether the costs are adequately supported and in compliance with Agreement provisions and State and federal regulations. CVAG entered into separate agreements with SunLine Services Group (SSG) to provide Regional PM10 street sweeping services. SSG performed the street sweeping services and billed CVAG per the separate agreements. This audit is performed as a management service to the Department to assist in its fiduciary responsibility to State and federal regulatory agencies.

CVAG's management is responsible for the claimed costs, compliance with Agreement provisions and State and federal regulations, and the adequacy of its financial management system to accumulate and segregate reasonable, allocable, and allowable costs.

Given that SSG incurred the street sweeping costs, we conducted an incurred cost audit of SSG's financial management system to determine whether the costs incurred by SSG and billed to CVAG, were reasonable in nature and amount, adequately supported, and in compliance with agreement provisions and state and federal regulations. We also audited SSG's financial management system to determine whether it is adequate to accumulate and segregate reasonable, allocable, and allowable costs. The results of our audit of SSG are detailed in the attached audit report. See Attachment II.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. The audit was less in scope than an audit performed for the purpose of expressing an opinion on the financial statements of CVAG and SSG. Therefore, we did not audit and are not expressing an opinion on CVAG's or SSG's financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and records selected. An audit also includes assessing the accounting principles used and significant estimates made by the agencies, as well as evaluating the overall presentation.

The scope of the audit was limited to financial and compliance activities related to Agreements CML-6164(10) and CML-6164(16). Our audit of CVAG's financial management system was limited to interviews of CVAG staff necessary to obtaining an understanding of CVAG's administrative procedures in relation to CVAG's management of the street sweeping program and did not include detailed tests of transactions of CVAG's accounting records as CVAG subcontracted the work to SSG. The audit consisted of an evaluation of compliance with 49

Code of Federal Regulations (CFR) Part 18 and Office of Management and Budget Circular (OMB) A-87 for the reimbursement of costs totaling \$7,367,566 during the period of November 1999 through May 2004. Our field work was completed in December 2004 and transactions occurring subsequent to this date were not tested and, accordingly, our conclusion does not pertain to costs or credits arising after this date. Due to inherent limitations in any financial management system, misstatements caused by error or fraud may occur and not be detected. Also, projections of any audit of the financial management system to future periods are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We initially issued our draft report dated March 30, 2005 and received a written response from CVAG dated April 26, 2005. We issued a second draft report on May 8, 2007 and received CVAG's response dated September 27, 2007. Our findings and recommendations take into consideration CVAG's response dated September 27, 2007. Our findings and recommendations, a summary of CVAG's response, and our analysis of the response are set forth in the Findings and Recommendations to this report. See Attachment IV for a copy of CVAG's full response.

BACKGROUND

As the Regional Transportation Planning Association in the Coachella Valley, CVAG was granted Congestion Management/Mitigation and Air Quality Improvement (CMAQ) funds to implement and monitor a program that would reduce particulate matter less than 10 microns (PM10) in the Coachella Valley as per the State Implementation Plan. The program is known as Regional PM10 Street Sweeping (street sweeping). In November 1999, CVAG obtained the services of SSG to operate the program.

CONCLUSION

Based on our audit, costs claimed by and reimbursed to CVAG, totaling \$5,189,968, were not adequately supported nor in compliance with the Agreement provisions and State and federal regulations. In addition, we found that CVAG's agreements with SSG did not contain adequate fiscal provisions, and CVAG's procedures for reviewing, approving and reimbursing SSG's costs were not adequate to ensure that SSG was reimbursed for reasonable, allowable and allocable project costs. We also noted a 19-month period during the street sweeping program when there were no signed agreements between CVAG and SSG. Our audit determined that \$5,189,968, including reimbursed operational costs of \$4,599,635 and equipment costs of \$590,333 are unallowable. See Attachment III.

This report is intended for the information of the Department, the Federal Highway Administration, the California Transportation Commission, and CVAG. However, this report is a matter of public record and its distribution is not limited.

If you have any questions, please contact Teresa Greisen, Audit Manager, at (916) 323-7910 or myself, at (916) 323-7105.

ORIGINAL SIGNED BY:

MARYANN CAMPBELL-SMITH
Chief, External Audits

Attachments

Audit Team

Teresa Greisen, Audit Manager
Teresa Muñoz, Auditor

FINDINGS AND RECOMMENDATIONS

Finding 1 – Unallowable Program Costs incurred by SSG

The audit of the costs incurred by SSG and reimbursed by CVAG determined that \$4,789,522 of costs is unallowable. See Attachment II. However, CVAG only billed the Department \$4,630,775 including unallowable reimbursed operational costs of \$4,599,635 and equipment costs of \$31,140. See Attachment III.

Recommendation

We recommend that CVAG reimburse the Department \$4,630,775.

CVAG's Response

CVAG did not agree with our finding and recommendation based upon the following:

- A) CVAG obtained adequate documentation from SSG in support of program costs.
- B) The scope of the audit must be limited to the three-year record retention period.
- C) SSG performed the services required by CVAG.
- D) SSG's payroll records reasonably support true payroll costs.
- E) Credits for services to other agencies represent the actual cost of providing the services.
- F) Payments made to CVAG by Caltrans occurred after SSG's check and invoice for equipment purchase was cashed and paid.
- G) The mathematical formula for the calculation of local match is reasonable.

Auditor Analysis

Although we agree with points C and F, we maintain that the costs incurred by SSG and reimbursed by CVAG totaling \$4,630,775 are unallowable given the following:

- A) Adequate supporting documentation was not provided to CVAG nor maintained by SSG. The intermingling of SunLine and SSG operations combined with weak internal controls inhibited the agencies' ability to provide adequate supporting documentation for billed costs. See Finding 1 of the May 8, 2007 report at Attachment II.
- B) We agree that the scope of the audit must be limited to the three-year record retention period provided for within the Master Agreement between CVAG and Caltrans.

Our records indicate that CVAG has entered into two separate program supplements for the Clean Streets Management project. Program supplement numbers M002 – CML-6164(10) and M008 – CML-6164(016) dated September 21, 1999 and December 19, 2002, respectively. Program supplement M002 was final vouchered in April 2005 while program supplement M008 is still open.

Therefore, for program supplement M002, CVAG is obligated to maintain all related documents until April 2008. Our audit was initiated prior to this time.

The record retention period for program supplement M008 will not begin until that project has been final vouchered. To our knowledge, CVAG received payment from this supplement as recently as November 2007.

- C. We do not dispute the fact that SSG provided street cleaning services within the Coachella Valley as per the agreement with CVAG.
- D. Although SSG's payroll records reflect actual payroll costs, due to the intermingling of the agencies, coupled with inadequate timekeeping procedures, we are not assured that the labor billed to CVAG does not also include non-program costs such as SunLine labor or the costs associated with sweeping non-program miles.
- E. Given the weaknesses identified above, we are not assured that the credit for services to other agencies accurately reflects SSG's actual costs of performing non-program mile street sweeping.
- F. We agree that Caltrans did not reimburse CVAG prior to SSG checks being cashed.
- G. As stated in SSG's draft report dated March 30, 2005, the mathematical calculation used in determining local match resulted in the billing and reimbursement of unsupported costs over and above the reported actual costs. During the time that SSG performed the street sweeping services for CVAG, SSG was reimbursed 100% or more, of the reported costs.

Finding 2 – Approval and Payment of Incomplete SSG Invoices & Inadequate Verification of Payment

CVAG did not have written policies and procedures for reviewing, approving, and reimbursing SSG for reasonable, allowable, and allocable program costs.

We audited the invoices submitted by SSG to CVAG for reimbursement of program costs. (See SSG audit report at Attachment II) Each invoice included a summary of expenditures by general ledger accounts. Such expenditures included labor, fringe benefits, overhead, fuel, equipment parts and supplies. Supporting documentation for these costs were limited to copies of SSG's monthly general ledger account history, work orders and vendor invoices. The lack of detailed support such as time records, overhead detail and fuel logs, made it difficult for CVAG to determine the nature and reasonableness of the billed costs.

Additionally, the audit of SSG found that SSG performed street sweeping services for other agencies. The costs of providing street sweeping services to other agencies were included in SSG's invoices to CVAG. A credit was included on each of the invoices which represented the cost of performing street sweeping for other agencies. CVAG did not obtain detailed

documentation or information to support each credit. During the audit, SSG was unable to identify the actual miles and associated costs for providing street sweeping services to the other agencies. Notwithstanding, CVAG approved and paid SSG's invoices as presented.

Furthermore, CVAG reimbursed equipment costs which had not yet been paid by SSG. Although SSG provided copies of checks to CVAG as proof of payment, we found several instances in which the checks were subsequently cancelled and re-issued after SSG had received payment from CVAG.

It is CVAG's responsibility to ensure that the program is administered within the guidelines and provisions set forth in the Agreements. The master agreement between the Department and CVAG requires compliance with CFR 49, Part 18. Subpart C Section 20(b) of CFR 49, Part 18 states "The financial management systems of other grantees and subgrantees must meet the following standards . . . (6) Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc." Such accountability is imperative as CVAG is accountable to the Department and the public to ensure that funds are administered in accordance with federal and state requirements, guidelines, and regulations as well as the Agreement provisions.

Recommendation

We recommend that CVAG establish policy and procedures for reviewing and approving all third party invoices including agency requests for reimbursements. The procedures should require a thorough review of all costs submitted for reimbursement as well as adequate supporting documentation. The procedures should limit reimbursement to costs that are reasonable, allowable, incurred, paid and properly documented and supported. The established procedures must be consistently applied to all third parties, including local government agencies.

CVAG's Response

CVAG agrees with the recommendation and will establish policy and procedures for reviewing and approving all third party contracts. In addition, CVAG will modify any current agreements to ensure that reimbursement is made for costs that are reasonable, allowable, incurred, properly documented, and supported.

Auditor Analysis

No additional analysis required.

Finding 3- Unsigned Agreements & Absence of Agreement

CVAG and SSG did not maintain signed agreements for 19 months of the street sweeping program. In fact, from November 1999 through February 2000, a contract did not exist. However, CVAG continued to reimburse SSG for all program expenditures from November 1999 through June 2004.

The master agreement between the Department and CVAG requires compliance with CFR 49, Part 18. Subpart C Section 20(b) of CFR 49, Part 18 (6) states "Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc."

Therefore, "award documents", contracts/agreements, are required to be maintained by the recipient. Lacking a signed agreement, the costs incurred by SSG and reimbursed by CVAG for the periods in which a signed contract did not exist are unallowable. The amount reimbursed to CVAG during the periods in which a contract was not in place totals \$2,022,996. However, \$1,432,663 of operational and \$31,140 of equipment costs are already included within the unallowable program costs totaling \$4,630,775 detailed in Finding 1. The difference of \$559,193 should be reimbursed to the Department. See Attachment V.

Recommendation

We recommend that CVAG reimburse the Department \$559,193 for unallowable equipment costs. We recommend that CVAG establish stringent policy and procedures requiring complete and signed contracts for all third party service agreements prior to the commencement of services.

CVAG'S Response

The agreements with SSG were consistent with the Local Program Procedures Manual, and binding upon approval by CVAG's legislative body. As such, CVAG does not concur with the finding.

Auditor Analysis

We do not agree with CVAG's position that adequate contracts were in place between CVAG and SSG from November 1999 through June 2004. We do not agree that Executive Committee approval at board meetings for CVAG to enter into agreements with a consultant constitutes a valid agreement between CVAG and SSG.

Finding 4 – Lack of Agreement Provisions

We reviewed the service agreements between CVAG and SSG. We determined that the agreements lacked several important fiscal provisions including the cost principles, administrative requirements, accounting system and single audit language. Other clauses such as the method of payment, record retention, matching requirements and right-to-audit were insufficient. Although the SSG agreement language was insufficient, at this time, amending the expired contracts would not benefit either party.

Recommendation

We recommend that CVAG include fiscal provision requirements in their policy and procedures established for third party agreements. See Attachment VII for the recommended fiscal provision language.

CVAG's Response

CVAG agrees with a portion of the contract language recommendations and has included revised provisions within their current agreement with CleanStreet, SSG's successor for the street sweeping program. CVAG referenced various sections of their current street sweeping agreement with CleanStreet as well as sections of the related Request for Proposal (RFP) to document the recent contract language changes and additions.

Auditor Analysis

Based upon the information provided, CVAG's current contract for street sweeping services remains inadequate. Although portions of our recommendations have been incorporated into the existing street sweeping contract, pertinent clauses, most importantly the Cost Principles and Administrative Requirements have not been included. Agreements with independent contractors should include the cost principles of 48 CFR, Federal Acquisition Regulations Systems. Chapter 1, Part 31 to determine allowability of project costs.

ATTACHMENT I

**INCURRED COST AUDIT OF THE COACHELLA VALLEY ASSOCIATION OF
GOVERNMENTS**

**AUDIT POPULATION – SUMMARY OF COSTS PAID TO CVAG BY THE
DEPARTMENT**

Attachment I
Summary of SunSweep Costs Paid by the Department
to CVAG
for the period of
11/1/99 - 5/31/04

CVAG Invoice No.	Date of Invoice	SSG Amount Operations	SSG Amount Equipment	Total by Invoice
1	4/28/2000		164,775.58	164,775.58
3	1/9/2001	41,067.71		
		65,600.93		
		62,134.90		
		61,826.50		
			263,752.93	
			161,804.01	
		88,391.96		
		70,016.80		
		50,202.21		
		71,700.28		936,498.23
6	3/26/2001	45,565.21		
		69,280.44		
		63,216.63		
		80,802.34		
		90,240.22		
		64,764.90		
		74,374.07		
		66,607.94		554,851.75
9	5/31/2001	60,913.03		60,913.03
10	6/30/2001	88,792.74		
		72,251.26		
		68,759.49		
		(1,765.73)		228,037.76
12	8/31/2001	68,653.37		68,653.37
13	9/30/2001	69,734.34		69,734.34
14	10/31/2001	91,115.01		

Attachment I
Summary of SunSweep Costs Paid by the Department
to CVAG
for the period of
11/1/99 - 5/31/04

CVAG Invoice No.	Date of Invoice	SSG Amount Operations	SSG Amount Equipment	Total by Invoice
			2,500.00	93,615.01
15	11/30/2001	71,678.43		71,678.43
16	12/31/2001	66,462.14		66,462.14
17	1/31/2002	76,770.39		76,770.39
19	3/31/2002	69,800.72		
		74,079.40		143,880.12
20	5/31/2002	58,899.44		
		81,564.03		
		8,231.04		
		7,755.64		156,450.15
22	7/31/2002		10,339.91	
		138,201.94		
			504,222.91	652,764.76
24	9/30/2002		252,869.35	
		88,666.54		341,535.89
25	10/31/2002		274,772.08	
			372,477.34	647,249.42
27	1/13/2003		176,914.19	
			148,895.92	
			46,058.62	
			176,914.19	548,782.92
28	1/30/2003	83,856.68		
		126,651.59		
		76,971.09		
		85,533.56		
		80,369.91		453,382.83

Attachment I
Summary of SunSweep Costs Paid by the Department
to CVAG
for the period of
11/1/99 - 5/31/04

CVAG Invoice No.	Date of Invoice	SSG Amount Operations	SSG Amount Equipment	Total by Invoice
29	6/5/2003		55,727.77	55,727.77
30	6/30/2003		(137,386.04)	
			6,266.01	
		46,445.69		
		2,151.15		(82,523.19)
31	4/30/2004	39,648.83		39,648.83
32	8/10/2004	4,405.43		4,405.43
1	2/28/2003		176,914.19	
		87,678.52		264,592.71
3	6/30/2003		3,994.71	
			40,006.71	
		118,005.51		
		73,518.32		
		125,542.33		361,067.58
4	7/31/2003	118,335.65		
		90,352.29		
		129,906.75	66,110.15	404,704.84
5	8/30/2003	14,434.08		
		84,117.75		98,551.83
6	10/5/2003	9,346.42		
		116,946.19		126,292.61
7	1/30/2004	9,346.41		
		116,946.19		
		12,994.02		
		78,386.99		
		8,709.66		

Attachment I
Summary of SunSweep Costs Paid by the Department
to CVAG
for the period of
11/1/99 - 5/31/04

CVAG Invoice No.	Date of Invoice	SSG Amount Operations	SSG Amount Equipment	Total by Invoice
		85,365.21		
		9,485.02		
		74,381.92		
		8,264.66		
		80,349.90		484,229.98
8	4/30/2004	(9,346.41)		
		(116,946.19)		
		8,927.76		
		105,707.13		
		11,745.24		
		86,646.47		86,734.00
9	5/31/2004	9,627.38		
		52,806.29		62,433.67
10	7/31/2004	5,867.36		
		77,144.99		
		15,138.59		
		27,512.76		125,663.70
Totals		4,599,635.35	2,767,930.53	7,367,565.88

Total Operations & Equipment

7,367,565.88

ATTACHMENT II

**INCURRED COST AUDIT OF THE COACHELLA VALLEY ASSOCIATION OF
GOVERNMENTS**

INCURRED COST AUDIT - SUNLINE SERVICES GROUP

Memorandum

*Flex your power!
Be energy efficient!*

To: R. GREGG ALBRIGHT
Deputy Director
Planning and Modal Programs

Date: May 8, 2007

File: P1170-1978

From: MARYANN CAMPBELL-SMITH
Chief, External Audits
Audits & Investigations

Subject: Incurred Cost Audit – SunLine Services Group, Subrecipient to the Coachella Valley Association of Governments

We have audited the costs claimed by SunLine Services Group (SSG), subrecipient to the Coachella Valley Association of Governments (CVAG) totaling \$7,656,697 for the period November 1, 1999 through May 31, 2004. See Attachment I. The costs were reimbursed pursuant to Agreements CML-6164(10) and CML-6164(16) between the Department of Transportation (Department) and CVAG for Regional PM10 street sweeping services. CVAG entered into agreements with SSG to provide the street sweeping services. SSG performed the street sweeping services and billed CVAG per their agreements with CVAG.

SSG's management is responsible for the claimed costs, compliance with contract provisions and state and federal regulations, and the adequacy of its financial management system to accumulate and segregate reasonable, allocable and allowable costs.

Our audit was conducted in accordance with the Standards for Performance Audits contained in the *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States of America. The audit was less in scope than an audit performed for the purpose of expressing an opinion on the financial statements of SSG. Therefore, we did not audit and are not expressing an opinion on SSG's financial statements.

The standards require that we plan and perform the audit to obtain reasonable assurance about whether the data and records reviewed are free of material misstatement as well as whether material noncompliance with fiscal provisions relative to the contract have occurred. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and records reviewed. An audit also includes assessing the accounting principles used and significant estimates made by SSG, as well as evaluating the overall presentation. We believe that our audit provides a reasonable basis for our conclusion.

The scope of the audit was limited to financial and compliance activities related to the street sweeping services provided by SSG to CVAG. The audit consisted of tests of transactions supporting costs totaling \$7,656,697 reimbursed to SSG by CVAG, under CVAG's annual

agreements with SSG. Transactions arising prior to November 1, 1999 and subsequent to May 31, 2004 were not tested and, accordingly, we do not express a conclusion on costs or credits incurred prior to or after these dates. Conclusions expressed in this report pertain solely to SSG's compliance with state and federal regulations and contract provisions. Our audit included such tests as we considered necessary to achieve the following objectives:

- To determine whether SSG's financial management system was adequate to accumulate and segregate reasonable, allocable and allowable project costs.
- To determine whether the costs billed and reimbursed to SSG by CVAG, were adequately supported and in compliance with agreement provisions and state and federal regulations.

Because of inherent limitations in any internal control structure or financial management system, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the financial management system to future periods are subject to the risk that the financial management system may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We detailed our findings relative to SSG in our initial draft report dated March 30, 2005 and received a written response from SSG dated May 13, 2005. Subsequently, we issued a second draft report on September 7, 2006 and received SSG's response dated September 26, 2006. Our findings and recommendations take into consideration SSG's response dated September 26, 2006. Our findings and recommendations, a summary of the response and our analysis of the response are detailed below. See Attachment II for a copy of SSG's September 26, 2006 response.

BACKGROUND INFORMATION

As the Regional Transportation Planning Association in the Coachella Valley, CVAG was granted Congestion Management/Mitigation and Air Quality Improvement (CMAQ) funds to implement and monitor a program that would reduce particulate matter less than 10 microns (PM10) in the Coachella Valley as per the State Implementation Plan. The program is known as Regional PM10 Street Sweeping (street sweeping). In November 1999, CVAG became responsible for this program. At the same time, CVAG obtained the services of SSG to operate the program.

SSG was created through a Joint Powers Authority (JPA) in 1995, to enhance public/private partnerships in the Coachella Valley. SSG, for the period examined, performed street sweeping services, researched and developed alternative fuel technology and administered Taxi Services in the Coachella Valley. SunLine Transit Agency (SunLine) was created through a JPA in 1977 to provide transit service throughout the Coachella Valley. SSG shares headquarters in Thousand Palms, California, with SunLine Transit Agency. The two agencies are separate, legal entities that share facilities and executive staff. SunLine provides the services of accounting, procurement, and human resources to SSG.

As recipients of federal funds, both SSG and SunLine are required to obtain annual Single Audits. In 2002, the agencies contracted with the independent accounting firm of Ernst & Young to perform their audit of the fiscal year ended June 30, 2002. In May 2003, Ernst & Young issued their draft report. The draft report identified several internal control weaknesses and findings. Given the severity of the auditor's report, the Board of Directors (Board) implemented several major management changes. Specifically, the Board placed the General Manager (GM) and Chief Financial Officer (CFO) on administrative leave (subsequently, both individuals resigned in August of 2003). The Board immediately appointed an acting GM, who in turn retained an interim CFO to be responsible for daily operations. The CFO position was permanently filled in February 2004 while a new GM began in May 2005.

The issuance of the independent auditor's draft report created much media attention and caused the funding partners, including CVAG, the Riverside County Transportation Commission (RCTC), and the Department's District 8, great concern. As a result, our audit was initiated.

However, prior to our audit, the RCTC obtained the services of Macias Consulting Group (Macias), an independent consultant, to evaluate SunLine's and SSG's accounting and internal control systems. Macias issued their Operation Evaluation Report dated December 19, 2003. In their report, Macias identified numerous accounting and internal control deficiencies related to both agencies and noted a lack of distinction between the two agencies affecting the accuracy of financial reporting. On August 30, 2005, Macias issued its Follow-up Review and Skills Assessment Report of SunLine only. The report indicated that SunLine had made significant improvement in addressing the fifty-two recommendations made in the original Operation Evaluation Report.

The current management of SSG and SunLine has expressed its commitment to establish adequate accounting and internal control systems throughout both agencies. However, we are not expressing a conclusion on the adequacy of the current financial management system as the scope of our audit covered a prior period, ending May 31, 2004.

AUDIT RESULTS

Based on our audit work, SSG's financial management system was not adequate to accumulate and segregate reasonable, allocable and allowable project costs. Of the claimed and reimbursed expenditures of SSG totaling \$7,656,697 for street sweeping services, \$2,867,175 were adequately supported and in compliance with contract provisions and state and federal regulations. Through our observations, interviews with staff and examination of available records, we identified numerous internal control weaknesses that had a direct impact on our ability to verify billed and reimbursed costs totaling \$4,789,522. See Attachment III.

FINDINGS

Finding 1 –Intermingled Operations

SSG and SunLine are separate legal entities. However, during the period of our audit we found that the two agencies were commingling funds and did not conduct themselves as separate entities. Specifically, we noted the following:

- The agencies did not maintain separate bank accounts
For approximately the first two years of our audit period, SSG and SunLine did not maintain separate bank accounts.
- The agencies commingled cash
In the FY 2000 financial and single audits of both SSG and SunLine the independent auditors reported the entities commingled cash and a significant number of inaccurately recorded transactions required adjustments between the two entities. Additionally, the financial statements and single audits for both agencies for several of the years within the period of our audit contained findings related to weak internal controls within the financial management systems.
- SSG was not fiscally independent from SunLine
During the period of our audit, SSG was unable to cover its monthly payroll. SSG and SunLine maintained large “due to” and “due from” accounts between the two agencies. The main purpose of these accounts was to record amounts owed by SSG to SunLine as a result of SSG’s inability to reimburse SunLine on a monthly basis for the SSG payroll and other costs stemming from SSG’s poor cash flow.
- SSG and SunLine shared facilities and executive staff
SunLine provided SSG with the services of accounting, procurement, and human resources. However, we found that SunLine staff performing accounting and administrative functions and the shared executive staff of SunLine and SSG did not maintain timesheets identifying the time spent performing work for each entity. Since timesheets were not maintained there is a commingling of labor for the shared executive, accounting, and administrative staff. Therefore, there is no support for the indirect costs included in the billings to CVAG. For additional information regarding labor and indirect cost issues see findings #2, #3, and #4.
- SSG and SunLine did not conduct themselves as separate entities
The agreements for the street sweeping services were between CVAG and SSG. However, we noted over 60% of the invoices submitted for reimbursement to CVAG by SSG were on SunLine letterhead. We also noted more than 30% of the remittances from CVAG were posted to the SunLine account and numerous vendor invoices were addressed to SunLine rather than to SSG. Additionally, the 1999 and 2000 financial statements for SunLine represent the funding from CVAG to be a pass-through to SSG.

The commingling of funds between the two agencies combined with weak internal controls at both SSG and SunLine contributed to SSG’s inability to provide adequate supporting documentation for costs billed to CVAG for the street sweeping services.

SSG's JPA, Section I, 1.1 Agency Created, states that:

"SunLine Services Group shall be a public entity separate from the parties hereto and from SunLine Transit Agency." Section V, 5.1 Liabilities, states that "the debts, liabilities and obligations of SunLine Services Group shall be the debts, liabilities and obligations of SunLine Services Group alone and not the parties to this Agreement or of SunLine."

Recommendation: We recommend that SSG and SunLine implement procedures to properly segregate all transactions and staff time between the two agencies to ensure accurate financial data and records are maintained for each agency.

We recommend that a timekeeping system identifying specific work performed be established for the shared staff of SSG and SunLine and the SunLine staff performing administrative work for SSG. Additionally, SSG and SunLine should establish indirect cost allocation plans in compliance with OMB Circular A-87 and the Department's Local Program Procedures (LPP) Manual, 04-10, to properly account for indirect costs.

SSG'S Response: SSG did not agree with our finding and recommendations.

Auditor Analysis: Additional information and or documentation to support SSG's position was not provided. Given that SSG did not provide any additional information or documentation for analysis, our finding and recommendations remain unchanged.

Finding 2 – Unsupported Street Sweeping Costs

In addition to the street sweeping services performed under the CVAG agreements, SSG performed street sweeping services for other cities within the Coachella Valley. Specific routes were established throughout the area. SSG referred to CVAG routes as "participating/program" while the remaining routes were "non-participating/program." SSG did not segregate program and non-program labor or related operational costs in their financial management system. In its invoices to CVAG, SSG reported total costs incurred for the sweeping of all routes, both participating and non-participating. SSG then applied a percentage, which was not constant, to the total street sweeping costs for that period. The resulting dollar amount was subtracted from the total costs to arrive at the billable costs to CVAG.

Per SSG, on a yearly basis CVAG and SSG agreed upon a non-participating percentage which would be applied to the total costs (direct labor and related operational costs) of the street sweeping services. This set percentage was not based on actual historical data or supported by source documentation.

During our testing of direct labor costs, SSG did not provide adequate timecards in support of the direct labor costs billed. Drivers and mechanics were required to punch in and out on uniform timecards; however, the timecards did not indicate the program worked by the employee. Additionally, the timecards were not consistently completed and signed by the employee and their supervisor.

SSG explained that drivers were assigned specific routes, either program or non-program, and the drivers were required to complete daily time-logs that identified the date and route swept. Upon review of the time-logs, we found that the starting and ending times were not recorded for each route worked and the time logs were not signed by the employee and/or approved by a supervisor. Additionally, we found that some drivers swept more than one route in an eight hour day (sometimes both a program route and a non-program route), some drivers were assigned to act as floaters to complete unfinished routes or to fill in for drivers who were absent, and some drivers were assigned to act as a lead or supervisor as the need arose. During our testing we were unable to reconcile selected timecards to the time logs.

OMB Circular A-87, Attachment B, 8 h (5), requires timesheets to reflect an after the fact distribution of the actual activity of each employee. 49 CFR Part 18.20 (b) (1) requires that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

In addition, Section 9 – Books and Records, of the agreement between CVAG and SSG states:

“SSG and CVAG shall maintain complete, accurate and clearly identifiable records with respect to costs incurred for this project or under this Agreement.”

Based upon our review of the information provided, verification of the actual costs incurred for the participating/program work was not possible. We are not assured that all programs received an equitable distribution of the total incurred street sweeping costs.

Therefore, reimbursed street sweeping costs totaling \$4,789,522 are disallowed. This includes direct labor of \$2,441,168, related fringe benefits of \$1,277,201, equipment labor of \$31,140 and other street sweeping costs totaling \$1,040,013. See Attachments III and IV.

Recommendation: We recommend that SSG reimburse CVAG for all operational program costs billed and reimbursed for the period of November 1, 1999 through May 31, 2004 totaling \$4,789,522.

SSG’S Response: SSG did not agree with our finding and recommendations.

Auditor Analysis: Additional information and or documentation to support SSG’s position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 3 – Unsupported Overhead/Indirect Costs

Neither SSG nor SunLine maintained an established indirect cost allocation plan or indirect cost rates. Per Chapter 5.14 of the Department’s LLP, computation of the indirect cost rates must be based on OMB Circular A-87 and approved by a cognizant federal agency or by the Department’s Audits and Investigations. However, SSG billed and received reimbursement for indirect costs throughout the life of the agreements with CVAG, including indirect costs allocated to SSG by SunLine.

Additionally, neither SSG nor SunLine could support the billed indirect cost rates with employee time keeping records, allocation methodology, and/or supporting historical data in compliance with OMB Circular A-87.

The following reimbursed indirect costs (I/C) are unallowable as follows:

<u>Fiscal Years</u>	<u>Description</u>	<u>Exception</u>	<u>Amount</u>
2000-2004	Indirect Labor	no rate, no timesheets	\$185,956
2000-2004	Fringe Benefits	no rate, no timesheets	53,019
2000-2004	SunLine I/C	no rate	143,694
2000	Add'l. I/C	no support	<u>75,730</u>
Total			<u>\$458,399</u>

Recommendation: We recommend that SSG reimburse CVAG for all operational program costs billed and reimbursed for the period of November 1, 1999 through May 31, 2004, including unallowable indirect costs totaling \$458,399. The disallowed indirect costs are included in the disallowed program costs totaling \$4,789,522. See Attachment III.

We also recommend that both SSG and SunLine establish policies and procedures for identifying and accounting for all indirect costs, including labor. The agencies should establish a cost allocation plan and overhead rate(s) for use on all programs. If either agency plans to seek future reimbursement of indirect costs on contracts funded in full or in part by the Department, the Federal Highway Administration (FHWA) or the Federal Transit Agency (FTA), the plan and rates should be submitted to the Department for review and approval.

SSG'S Response: SSG did not agree with our finding and recommendation.

Auditor Analysis: Additional information and or documentation to support SSG's position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 4 – Duplicate Labor Billing

SSG purchased various pieces of equipment, including street sweepers, to perform the street sweeping services. All equipment costs were billed separate from operational costs. From April through July 2000, SSG included labor costs of SSG and SunLine employees within the equipment invoices to CVAG. The back-up submitted to CVAG was minimal and did not include employee timesheets or support for the hourly rates.

During our audit SSG could not distinguish these labor costs, totaling \$31,140, as separate and distinct from the labor billed with the operational invoices.

Section 9 – Books and Records, of the CVAG and SSG agreements states:

“SSG and CVAG shall maintain complete, accurate and clearly identifiable records with respect to costs incurred for this project or under this Agreement.”

Given that neither SSG nor SunLine employees kept adequate time keeping records to support the billed costs, the following additional labor billed within the equipment invoices is unsupported:

<u>Invoice Date</u>	<u>Description</u>	<u>Exception</u>	<u>Amount</u>
4/24/2000	Equip. Labor	no timesheets	\$ 5,104
6/29/2000	Equip. Labor	no timesheets	7,241
6/29/2000	Equip. Labor	no timesheets	11,122
7/22/2000	Equip Labor	no timesheets	<u>7,673</u>
Total			<u>\$31,140</u>

Recommendation: We recommend that SSG reimburse CVAG for unsupported equipment labor costs totaling \$31,140. The disallowed labor costs are included in the disallowed program costs totaling \$4,789,522. See Attachment III.

SSG'S Response: SSG did not agree with our finding and recommendation.

Auditor Analysis: Additional information and or documentation to support SSG's position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 5– Unsupported Match Costs

CMAQ funds require a local match funding commitment of 11.47%. Through our analysis of billed and reimbursed costs from November 1999 through May 2004, SSG billed CVAG for unsupported match costs totaling \$292,479. The local match amounts were not based on actual costs incurred by SSG or SunLine and were determined solely through mathematical calculations.

49 CFR Part 18.20 (b) (1) requires that accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.

Additionally, Section 9 -- Books and Records, of the CVAG and SSG agreements states:

"SSG and CVAG shall maintain complete, accurate and clearly identifiable records with respect to costs incurred for this project or under this Agreement."

Recommendation: We recommend that SSG reimburse CVAG for all operational program costs billed and reimbursed for the period of November 1, 1999 through May 31, 2004, including unsupported match costs of \$292,479. The unsupported local match costs are included in the disallowed program costs totaling \$4,789,522. See Attachment III.

SSG'S Response: SSG did not agree with our finding and recommendation.

Auditor Analysis: Additional information and or documentation to support SSG's position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 6 -- Unallowable Other Direct Costs

SSG billed and received reimbursement for other direct costs totaling \$21,358 which are unallowable per OMB Circular A-87, inequitably allocated or not related to the CVAG agreements as follows:

- SSG relied upon SunLine for financial and administrative functions. The costs of these services were recorded as liabilities in SSG's general ledger and were due to SunLine at a future date. SSG calculated interest on amounts due to SunLine and allocated such interest to the SunSweep program. Although the interest was recorded in the general ledger, the interest was not paid to SunLine. Lacking both service and loan agreements with SunLine and given that the interest was not paid, the interest expense is not supported. Furthermore, interest expense is expressly unallowable per OMB Circular A-87, Attachment B-23.
- SSG inequitably billed the program for the full cost of its Single Audit, or \$8,400. As stated in the LPP 04-10, Section 5.8:
"Local agencies are also subject to the audit requirements of the Federal OMB Circular A-133. A Single Audit is required if any agency receives more than \$300,000 in federal funds from all sources in their fiscal year."
As SSG received other federal funding, (NAC Program), such costs should have been allocated to all federal programs on an equitable basis.
- SSG billed certain costs which were not within the scope of the project tasks and therefore, ineligible for reimbursement under the SunSweep program per Section 3— Invoicing and Payment- of the agreements between CVAG and SSG. Specifically, the cost of towing a non-SunSweep vehicle and the cost of screen-printing for the SunBus program are unallowable project costs.

The various unallowable costs totaling \$21,358 are as follows:

<u>G/L Date</u>	<u>Description</u>	<u>Exception</u>	<u>Amount</u>
6/30/2000	Interest Allocated	Unallowable	\$15,891
6/30/2000	Interest Expense	Unallowable	579
4/1/2004	Caporicci & Larson	Inequitable alloc.	4,200
11/19/1999	Plaza Shell Towing	Non-program cost	585
11/30/1999	Foundation For Retarded	Non-program cost	103
Total			<u>\$21,358</u>

Recommendation: We recommend that SSG reimburse CVAG for all operational program costs billed and reimbursed for the period of November 1, 1999 through May 31, 2004, including unallowable other direct costs of \$21,358. The disallowed other direct costs are included in the disallowed program costs totaling \$4,789,522. See Attachment III.

SSG'S Response: SSG did not agree with our finding and recommendation.

Auditor Analysis: Additional information and or documentation to support SSG's position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 7 –Internal Control over Vehicle Parts Costs

SSG billed vehicle parts costs, which were not consistently supported by work-orders and the general ledger. Specifically, the methodology, procedures, and controls for tracking, recording, and billing part costs were unreliable. Work-orders often contained errors and miscalculations. These errors were transferred to the general ledger and billings to CVAG. Although most errors were discovered and eventually corrected, we have no assurance that all errors were properly identified and accounted for within the general ledger and billings to CVAG.

CFR 49 Part 18.20 (b) (2) Standards for financial management systems states:

"Accounting records. Grantees and subgrantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income."

Recommendation: SSG should ensure that the current procedures for accounting and billing of vehicle parts are adequate to safeguard assets and to identify errors and irregularities in a timely manner to assure the accuracy of financial records.

SSG'S Response: SSG did not agree with our finding and recommendation.

Auditor Analysis: Additional information and or documentation to support SSG's position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 8 – Lack of Policy and Procedure Manuals

Neither SSG nor SunLine maintained policy and procedure manuals for their accounting department. Written policy and procedure manuals are an integral component of effective internal control and accountability. Additionally, adequate written policies and procedures provide accounting staff instructions to perform their job duties efficiently, consistently, and accurately. Adequate policies and procedures can decrease the likelihood of accounting errors, inconsistencies, payment and billing of unallowable or ineligible program costs, late or non-payments to vendors, and erroneous entries to the general ledger. The lack of policy and procedure manuals increases the likelihood that misstatements are not prevented or detected and corrected in a timely manner, which could allow for theft or fraud and can lead to unreliable financial data and/or financial hardship.

CFR 49 Part 18.20 (b) (3) Standards for financial management systems states:

“Internal control. Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.”

Recommendation: We recommend that both SSG and SunLine establish formal written accounting policies and procedures. All employees should be held accountable to the requirements and standards of such policies and procedures. The policy and procedures should include details for all aspects of accounting including, but not limited to, the following:

- Accounts payable, accounts receivable, grant management, payroll and general ledger - The procedures should ensure segregation of duties, include duty statements for each accounting employee and identify backup personnel. The procedures should also include, but not be limited to, stringent internal controls over vendor payments, check stock and approvals (check signature).
- Charging practices - Procedures for properly identifying and accounting for all costs, including labor, as either an expense of direct or indirect programs.
- Timekeeping - Timekeeping/reporting procedures and policies for all employees. The procedures should establish standardized time keeping documents, require proper identification of program and non-program hours and the signature of both employees and supervisors.
- Travel - Procedures to ensure that all reimbursed employee travel is reasonable, necessary, documented, supported and authorized by designated personnel prior to incurring the expense.
- Record retention - Policies for maintaining pertinent financial documents. The policy should require all federal and state funded programs to maintain documents for a period not less than three years from the date of final payment.
- Billing to CVAG or other local, state and federal agencies- Procedures for seeking reimbursement of program costs from CVAG, the Department, or other local and federal agencies. The policy and procedures should limit reimbursement to allowable direct and indirect program costs. Reimbursement should be sought for only those costs incurred and paid at the time of billing. All costs included within billings must be adequately supported by source documents, cancelled checks and the general ledger.

SSG’S Response: SSG did not agree with our finding and recommendations.

Auditor Analysis: Additional information and or documentation to support SSG’s position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

Finding 9 – Lack of Service & Loan Agreements

SunLine provided financial and administrative services to SSG. Through journal entries, SunLine allocated labor and other costs to SSG. Portions of such costs were ultimately charged to the CVAG agreements.

As noted previously, neither agency maintained an adequate cost allocation plan per OMB Circular A-87 to support the allocation of costs between the agencies and programs. Additionally, the agencies did not maintain a written agreement for services provided to one agency from the other until April 2004. Good internal controls and sound accounting practice dictate that detailed agreements be in existence, detailing the services to be provided and the cost of such services. We reviewed the terms of the newly adopted agreement and found that the language was not clear as to the specific services to be provided and at what cost. Furthermore, a written, specific loan agreement between the agencies was not established. We noted that the agencies maintained “due to” and “due from” accounts on a continuing basis and that the expenditures included within the “due to” accounts included labor, fringe benefits and overhead.

Lacking adequate service and loan agreements, it is difficult to determine the appropriate services that were to be provided as well as the appropriate cost that was to be billed between both agencies.

Recommendation: We recommend that SSG and SunLine establish both service and loan agreements between the two agencies. The service agreement should be detailed and specific, identifying the nature, quantity and dollar amount of services to be provided between the two agencies including any overhead costs. The loan agreement should be a binding, legal document, stating the amount borrowed, applicable interest, if any, and a specific repayment schedule, with penalties if necessary.

SSG’S Response: SSG did not agree with our finding and recommendation.

Auditor Analysis: Additional information and or documentation to support SSG’s position was not provided. Given that SSG did not provide additional information or documentation for analysis, our finding and recommendation remain unchanged.

R. Gregg Albright
May 8, 2007
Page 13 of 13

This report is intended solely for the information of the Department Management and the Federal Highway Administration. However, this report is a matter of public record and its distribution is not limited.

ORIGINAL SIGNED BY:

TERESA K. MUÑOZ
Auditor

Approved:

ORIGINAL SIGNED BY:

MARYANN CAMPBELL-SMITH
Chief, External Audits

Attachments

c: Terry Abbot, Chief, Local Assistance
Michael A. Perovich, District Director, D8
John Wohlmuth, Executive Director, Coachella Valley Association of Governments
Brenda Bryant, Federal Highway Administration

Attachment I
Summary of Costs Reimbursed to SSG by CVAG
for the period 11/1/99 - 5/31/04

Total Costs Reimbursed to SSG (11/1/99 -5/31/04):
 Payments via Wire Transfer from CVAG:

	Date	Amount	
	5/4/2000	164,775.58	
	7/31/2000	230,630.04	
	7/31/2000	263,752.93	
	8/4/2000	161,804.01	
	8/4/2000	280,311.25	
	3/28/2001	303,509.17	
	6/11/2001	277,793.95	
	8/1/2001	262,499.42	
	8/31/2001	68,653.37	
	10/3/2001	69,734.34	
	11/7/2001	91,115.01	
	11/21/2001	2,500.00	
	12/13/2001	71,678.43	
	1/3/2002	66,462.14	
	2/4/2002	76,770.39	
	4/2/2002	143,880.12	
	6/11/2002	156,450.15	
	7/29/2002	725,657.80	
	10/1/2002	285,631.25	
	10/7/2002	88,666.54	
	11/6/2002	555,305.59	
	12/13/2002	199,835.30	
	1/10/2003	156,300.97	
	1/14/2003	199,835.30	
	1/30/2003	453,382.83	
	3/4/2003	199,835.30	
	3/10/2003	87,678.52	
	5/1/2003	271,635.83	
	6/3/2003	118,005.51	
	7/3/2003	302,286.55	
	7/28/2003	129,906.75	
	9/8/2003	109,450.18	
	10/2/2003	142,655.15	
	11/4/2003	103,220.39	
	12/2/2003	106,263.27	
	1/8/2004	94,732.80	
	1/30/2004	100,095.51	
	2/5/2004	44,785.76	
	3/12/2004	129,487.06	
	3/30/2004	111,139.40	
	5/7/2004	4,976.20	
	5/7/2004	70,522.61	
	6/2/2004	93,767.48	
	7/4/2004	48,177.28	
Payment by Check:			
	No. 8978	7/18/2002	11,679.55
	No. 3127	6/30/2004	19,460.19
Total Payments			<u>7,656,697.17</u>
Total Equipment Payments		2,898,314.75	
Total Operational Payments	4,746,702.87		
Add Check No. 8978	<u>11,679.55</u>		
		4,758,382.42	
Total Payments			<u>7,656,697.17</u>

Attachment II

*A Public Agency*

MEMBERS

Desert Hot Springs	Rancho Mirage	Indio
Palm Springs	Palm Desert	Coachella
Cathedral City	Indian Wells	Riverside County
	La Quinta	

September 26, 2006

Gregg Albright
Deputy Director
Caltrans
Department of Transportation
Planning and Modal Programs
Audits & Investigations
1304 "O" Street
Sacramento, CA 95814

Re: SunLine Services Group Response to Final Draft Audit, DOT.
File# P1170-1978

Dear Mr. Albright:

This letter is written on behalf of SunLine Services Group (SSG) in response to the Revised Second Draft of Interim Audit of SSG (Caltrans Audit) issued by Teresa Greisen of Caltrans.

The Caltrans Audit covers a period of time between November 1, 1999 and May 31, 2004. In early July 2003, the Board Directors of SunLine Transit Agency (SunLine) placed the general manager and chief financial officer for both SunLine and SSG on administrative leave. Both officers resigned shortly thereafter and many employees with significant responsibility for the street sweeping program subsequently resigned or were laid off.

Since 2003, both SSG and SunLine have devoted considerable effort to correct and address deficiencies of prior management, including those described in the Caltrans Audit. Immediately after prior management employees resigned, a special audit to evaluate internal control systems was conducted by Macias Consulting Group, Inc. Ms. Greisen noted the 52 areas of deficiency in the initial Macias report. The Follow-Up Report issued by Macias in August of 2005 found that 41 of its recommendations had been fully implemented, that 6 of the remaining recommendations no longer applied and that of the 5 remaining recommendations – 3 had been partially implemented. Only two of its recommendations had not then been implemented.

SSG has long since discontinued the streetsweeping services that were the subject of the audit; however, at the time SSG was under contract to the Coachella Valley Association of Governments (CVAG) as a vendor. During the term of the contract, SSG provided monthly invoices consisting of several hundreds of pages each in accordance with Caltrans billing criteria related to SSG through CVAG. SSG understands that its monthly invoices were submitted to Caltrans for review prior to payment. CVAG was required under its agreements with SSG to "promptly" notify SSG of any issue on the part of any of its invoices raised by Caltrans or CVAG. From November 1, 1999 through May 31, 2004, Caltrans approved the SSG invoices for payment through CVAG and back to SSG.

Gregg Albright, Deputy Director
September 26, 2006
Page 2

The recommendations in Ms. Greisen's audit calls for reimbursement of many millions of dollars for efforts that were unquestionably devoted to approved streetsweeping tasks properly performed by SSG under its contract with CVAG. SSG employees were paid to perform this work over many years and SSG has provided Caltrans with boxes of time and payroll records in support of these costs. SSG expended considerable staff time in assembling and producing volumes of documents, time sheets, the bid sheets and other records requested by the Caltrans auditors in support of streetsweeping costs.

Current management remains committed to maintaining the integrity of the financial management systems for both SunLine and SSG, as demonstrated for the past several years. SSG is confident that both it and CVAG will be successful in defending the vast majority of the costs questioned in the Caltrans audit going forward.

Sincerely,

ORIGINAL SIGNED BY:

C. Mikel Oglesby
General Manager

cc: SunLine Services Group Board of Directors
Michael Wilson, Chairman of the Board

Attachment III
Schedule of Unallowable and Allowable SSG Program Costs
for the period of 11/1/99-5/31/04

Total Billed & Reimbursed Equipment Costs	2,898,314.75	
Total Billed & Reimbursed Operational Costs	<u>4,758,382.42</u>	(1)
Total Reimbursed Costs		7,656,697.17
Less:		
Unallowable Equipment Costs - Duplicate Labor	(31,140.00)	
Unallowable Operational Costs:		
Labor	(2,441,167.49)	
Fringe Benefits	<u>(1,277,201.34)</u>	(3,718,368.83)
Overhead	(458,399.00)	
Match	(292,479.00)	
Other Direct Costs	(21,358.00)	
(2) Other Billed Costs	<u>(267,777.59)</u>	<u>(1,040,013.59)</u>
	<u>(4,758,382.42)</u>	
Total Unallowable Costs		<u>(4,789,522.42)</u>
Allowable Costs		<u><u>2,867,174.75</u></u>

(1) Operational Pmnts. - Wire transfer	4,727,242.68
Operational Pmnts. - Checks	<u>31,139.74</u>
Total Operational Costs	4,758,382.42

(2) Total Operational Costs	4,758,382.42
Less:	
Labor	(3,718,368.83)
Overhead	(458,399.00)
Match	(292,479.00)
Other Direct Costs	<u>(21,358.00)</u>
Other Billed Costs	<u>267,777.59</u>

Attachment IV
Summary of SSG
Reimbursed Direct Labor Costs
for the period 11/1/99-5/31/05

G/L Account No.	Account Title	Amount Nov, 1999 - May 2004
815010101010	SunSweep Drivers	1,495,339.12
815010101020	SunSweep Drivers-Overtime	50,603.57
815010101200	SunSweep Mechanics	350,989.77
815010101210	SunSweep Mechanics-Overtime	27,687.61
815010200500	MGR/DIR/ADM Wages & Salaries	155,578.29
815010201500	Supervisor Salaries	221,306.33
815010201510	Supervisor Salaries-Overtime	9,190.55
815010201600	Staff/Clerical Salaries	94,507.75
815010201610	Staff/Clerical Salaries-Overtime	1,917.19
815010201700	SunSweep Utility	33,802.77
815010201710	SunSweep Utility-Overtime	244.54
	Subtotal Direct Labor	2,441,167.49
815020100010	Medicare Tax	43,889.55
815020100020	Social Security Taxes	1,521.55
815020202000	Pension	250,771.61
815020300000	Group Health Insurance	304,398.78
815020400000	Dental Plans	17,783.27
815020500000	Group Life Insurance	8,791.05
815020600000	Group Disability Insurance	5,452.25
815020600001	?	95.60
815020700000	SDI	-
815020700010	SUTA	13,587.73
815020700020	FUTA	-
815020800000	Workers Compensation Insurance	134,455.55
815020900000	Sick Pay	78,488.87
815020900001	Sick Pay Cash Sellbacks	24,506.19
815021000000	Holiday Pay	82,065.51
815021100000	Vacation Pay	173,522.19
815021100001	Vacation Pay Sellbacks	68,933.65
635021100002	Final Payout of Vacation Pay	10,147.04
815021200000	Miscellaneous Pay	17,100.96
815021400000	Deferred Compensation Expense	9,061.99
815021402260	Operator Incentive Pay	32,628.00
	Subtotal Fringe Benefits	1,277,201.34
	Totals	3,718,368.83

ATTACHMENT III

**INCURRED COST AUDIT OF THE COACHELLA VALLEY ASSOCIATION OF
GOVERNMENTS**

SCHEDULE OF UNALLOWABLE COSTS

Attachment III
Schedule of Unallowable and Allowable
CVAG Street Sweeping Program Costs
for the period of 11/1/99-5/31/04

Total Billed & Reimbursed Equipment Costs	2,767,930.53	
Total Billed & Reimbursed Operational Costs	<u>4,599,635.35</u>	
Total Reimbursed Costs		7,367,565.88
Less SSG Audit Findings:		
Unallowable Equipment Costs - Duplicate Labor	(31,140.00)	
Unallowable Operational Costs:		
Labor	(2,441,167.49)	
Fringe Benefits	<u>(1,277,201.34)</u>	(3,718,368.83)
Overhead	(458,399.00)	
Match	(292,479.00)	
Other Direct Costs	(21,358.00)	
(2) Other Billed Costs	<u>(109,030.52)</u>	<u>(881,266.52)</u>
	<u>(4,599,635.35)</u>	
Total Unallowable Costs based upon SSG Audit		(4,630,775.35)
Less Unallowable Equipment Costs -		
No agreement with SSG	(590,333.00)	
Duplicate Labor	<u>31,140.00</u>	<u>(559,193.00)</u>
Total Unallowable Costs		(5,189,968.35)
Allowable Costs		<u><u>2,177,597.53</u></u>
(2) Total Operational Costs	4,599,635.35	
Less:		
Labor	(3,718,368.83)	
Overhead	(458,399.00)	
Match	(292,479.00)	
Other Direct Costs	<u>(21,358.00)</u>	
Other Billed Costs	<u>109,030.52</u>	

ATTACHMENT IV

**INCURRED COST AUDIT OF THE COACHELLA VALLEY ASSOCIATION OF
GOVERNMENTS**

CVAG'S RESPONSE TO AUDIT DATED SEPTEMBER 27, 2007



COACHELLA VALLEY ASSOCIATION of GOVERNMENTS

• Cathedral City • Coachella • Desert Hot Springs • Indian Wells • Indio • La Quinta • Palm Desert • Palm Springs • Rancho Mirage
County of Riverside • Agua Caliente Band of Cahuilla Indians • Cabazon Band of Mission Indians • Torres Martinez Desert Cahuilla Indians

September 27, 2007

Teresa Greisen
Audits and Investigations, MS - 2
California Department of Transportation
1304 "O" Street, 2nd Floor, Suite 200
P.O. Box 942874
Sacramento, CA 94274-0001

Re: Draft Audit – File P1170-1978

Dear Ms. Greisen:

By this letter, the Coachella Valley Association of Governments (CVAG) respectfully requests that the May 8, 2007 draft audit of the Regional PM10 Street Sweeping Program (the "Draft Audit") be amended in consideration of the responses presented here.

In preface, let me say that CVAG has in every instance responded to all suggestions made by Caltrans when, and as soon as, circumstances permitted. For example, the work was put out for public bid in response to concerns about extending the contract with SunLine Transit Agency/SunLine Services Group (SSG). All suggestions with respect to contract language were immediately incorporated into the new contract with CleanStreet, Inc. In other words, where a criticism might be cured prospectively, CVAG is committed to accepting the Department's suggestions without further examination. The attached detailed response, then, address only those two findings in the Draft Audit that prospective action cannot cure.

The following summarizes the CVAG response to each of the four findings.

Finding 1 – Unallowable Program Costs incurred by SSG

- A. Except for an increased level of required documentation, CVAG utilized the same format (including provision for credits) that Caltrans utilized when Caltrans administered the program directly. Prior to the 2003 Ernst & Young annual single audit of SSG, there were no circumstances that would have put CVAG on notice of the need to do a more extensive audit of the scope subsequently initiated by Caltrans.
- B. To the extent that the audit recommends reimbursement based on the absence of sufficient documentation, the scope of the audit must be limited to the three-year record retention period as set out in 49 CFR 18.42(c). As the grant support was continued or renewed on an annual basis, the three-year retention period for each annual term commenced on the date that SSG submitted its last invoice for that term.

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- C. SSG did, in fact, perform the services. A wholesale disallowance of 100 percent of all payroll expenses is unprecedented and punitive.
- D. SSG's payroll records do reasonably reflect true payroll costs.
- E. The credits for the services to other agencies represent the actual cost of providing those services which is appropriately carved out of the total cost of all street sweeping services.
- F. CVAG's acceptance of a copy of SSG's check and invoice for equipment purchases was reasonable verification of the expense. The check was cashed and paid prior to any reimbursement by Caltrans.
- G. The mathematical formula for the local match is not unreasonable given SSG's ability to document its total actual costs.

Finding 2 – Approval and Payment of Incomplete SSG Invoices & Inadequate Verification of Payment

- A. CVAG has agreed to the recommendation and has implemented the recommendation from 2004 to current.

Finding 3 – Unsigned Agreements & Absence of Agreement

- B. The agreements with SSG for each term of the program were in a form consistent with the Procedures Manual, and binding upon approval by CVAG's legislative body. No reimbursements were made prior to the existence of a corresponding and binding contract.

Finding 4 – Lack of Agreement Provisions

- C. CVAG has adopted the contract language recommendations and revised all agreements from 2004 to current accordingly.

A detailed CVAG response to Findings 1 and 3 is attached to this letter. Thank you in advance for your consideration of CVAG's response. I look forward to receipt of a revised audit.

Respectfully submitted,

ORIGINAL SIGNED BY:

John Wohlmuth
Executive Director

cc: William Mosby
Caltrans District 8, San Bernardino

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CVAG'S DETAILED RESPONSES TO CALTRANS DRAFT AUDIT

Finding #1 – Recommendation that CVAG reimburse "unallowable" reimbursed costs of \$4,630,775.

It appears that the proposed finding is that one-hundred percent of the entirety of SSG's direct personnel costs, and the entirety of the related overhead, has been characterized as "unallowable." First, it should be noted that the period of the Draft Audit is inclusive of every term of SSG's service *except* the initial three-year period that was administered directly by Caltrans. This was a novel program unlike any other. Management systems applicable to, for example, the construction of a bridge or the widening of a specific stretch of highway, cannot necessarily be applied wholesale to a program for the sweeping of existing roadway. With the exception of the outside contracts (discussed below), all of the management issues raised in the Draft Audit of the term of CVAG's administration existed during the term that Caltrans directly administered the program (see Local Agency-State Agreement No. 08-6052, Program Supplement Agreement No. M002, Project No. CML-6052(004), dated October 9, 1996). Indeed, the form of the invoice for the services was dictated by Caltrans, and carried forward during CVAG's administration of the program -- except that CVAG required significantly more documentation than was required when Caltrans processed SSG's invoices directly. Attachments 1 and 2 are copies of SSG Invoice No. 1 and Invoice No. 27 (the first and the last) and back-up documentation submitted directly to Caltrans. I point this out only to illustrate that the administrator is charged with management but not perfection or omniscience. Just as Caltrans reasonably accepted SSG's management and operations systems during the term of Caltrans' direct administration, so too was CVAG's acceptance reasonable. It must be emphasized that the current Draft Audit gives a retrospective perspective that was simply not available or even indicated at any time prior to the 2003 Ernst & Young annual single audit. Indeed, no prior annual single audit ever identified the management issues noted in the 2003 Ernst & Young single audit or the Department's current Draft Audit.

Second, the absence of documentation for any period of time beyond three-years from the last invoice of the last annual term of the street sweeping services should not be a basis for disallowing a prior reimbursement. 49 CFR 18.42(c) reads (emphases added) "When grant support is continued or renewed at annual or other intervals, the [3 year] retention period for the records of *each* funding period starts on the day the grantee or subgrantee submits to the awarding agency its single or last expenditure report for *that* period." The grant support in this instance was renewed on an annual basis. Accordingly, the retention period for each annual term began on the date that SSG submitted its last invoice for that term. Further, under the auditors' analysis that the extension of each term was not a mere supplement to the original contract, that each term required a stand-alone contract (which the auditors assert must have been signed before the new contract was effective), then each stand-alone contract triggered a new retention period.

The public policy underlying the three-year retention rule is exemplified here by the prejudice to CVAG as it is forced to sort, gather and interpret documentation that was created eight years ago by CVAG and/or SSG staff that is no longer employed by those agencies.

CVAG acknowledges that the three-year retention period was extended from the date that Caltrans first notified SSG of the current audit. CVAG also acknowledges that any

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performed. Throughout the implementation of the program, CVAG subcommittees supervised, investigated and made recommendations with respect to the efficiency of the program. A formal audit by Diehl, Evans & Co. was undertaken. None of the single audits pre-2003 revealed any misrepresentations with respect to the execution of the work.

Assuming that the required scope of the work was performed, as CVAG reasonably did when it negotiated and processed the credits, the formula is an accurate reflection of the portion of the street sweeping expenses to be excluded from reimbursement under the grant.

Sixth, CVAG's acceptance of a copy of the check and the invoice for the equipment expenditures was a reasonable means of verifying the propriety of the reimbursement. CVAG staff has scoured the Local Procedures Assistance Manual (the "Manual") and believes that CVAG did comply with all the guidelines for documentation; staff does not find any provisions that define a "cancelled" check as an absolute requirement. Indeed, during the initial three-year period that Caltrans administered the program directly, Caltrans processed such expenditures without a cancelled check just as CVAG did. 49 CFR § 18.20(b)(6) sets out *examples* of source documentation; it does not create an absolute requirement for a "canceled check." If that was what was intended, the section would read: "Accounting records must be supported by cancelled checks." Instead, that section simply illustrates some of the documentation that would be acceptable. In any event, it is undisputed that the payment had been made before Caltrans reimbursed CVAG for the expenditure.

Seventh, the mathematical formula for the local match is not unreasonable given SSG's ability to document its total actual costs.

CVAG does not dispute Finding 6 within the SSG draft audit regarding \$21,358 in improper cost allocations.

In sum, CVAG requests that the scope of Finding 1, which is based entirely on the adequacy of SSG's records, be narrowed to the three-year record retention period; that the equipment expenses that were not reimbursed by Caltrans until after the expenses were actually paid be allowed; and that any penalty for SSG's failure to document the program/non-program credits differently be limited to a penalty commensurate with the true risk of an actual overpayment, if any.

Additionally, CVAG proposes that, collectively, the SSG and CVAG draft audits be edited to recommend SSG make reimbursement directly to Caltrans so that CVAG is not forced to act as an intermediary for collection of penalties that it does not support.

Finding #3 – Recommendation that \$559,193 be disallowed because of late signatures on the contract documents.

CVAG staff has scoured the Manual on this issue as well. Certainly a contract must be in place prior to reimbursement. The issue is at what point was a contract in place. CVAG maintains that, as a matter of law, the contract was in place (as measured by SSG's ability to enforce CVAG's obligations thereunder) when CVAG's legislative body approved the first contract. The supplement to the original contract was in place on each successive approval of an extension of the term.

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The Manual describes all of the required contents of the contract, including an effective date (term) and signatures. It does not state that the signature lines must be dated, or that the contract must include the date of the last signature. Rather, the Manual requires that the text of the contract state the term. Every contract that was considered in the Draft Audit states a term. Every request for reimbursement was within the stated term.

Unlike a general law city, there is no statute or other regulation applicable to CVAG (or a joint powers agency) that requires specific signatures or formalities to the existence of a contractual obligation. Approval of a contract, by CVAG's legislative body, followed by the official minutes, constitutes a writing that binds CVAG. See, for example, Youngman v. Nevada Irrigation District (1969) 70 Cal.2d 240, 246, where our Supreme Court held that the public agency was obligated upon approval of the terms by the governing body notwithstanding the absence of a signed agreement.

Further, there is no regulation or requirement that the agency's Executive Director sign contracts in order to make the contract valid. Typically, CVAG's Executive Director signed last – however his/her signature was superfluous because the Chair of the legislative body had already signed.

As an independent basis for correction of the Draft Audit, CVAG should not be penalized for an inability to produce further documentation for the two original terms. The earliest term of service for which CVAG previously produced a fully executed written agreement was March 1, 2000 through February 28, 2001. The last invoice under that agreement was received by CVAG on June 14, 2001. Thus, the retention period for documents supporting those expenses expired mid-2004.

Documentation for the prior term (the first term for services rendered from November 10, 1999 through February 28, 2000) is necessarily outside the three-year retention period. Although CVAG cannot now find CVAG's signature, Attachment 3 is a copy of the contract signed by SSG and returned to CVAG on October 11, 1999. That original agreement contemplated a term beginning October 1, 1999 and continuing "until the date AGENCY provides a written Notice of Completion to CVAG." A Notice of Completion has never been issued. Further, CVAG should not be penalized for its inability to locate the original with CVAG's signature because the document predates the three-year retention period.

Additionally, no invoice was received by CVAG for the November 1999 through February 2000 term until July 18, 2000. Payment by CVAG to SSG would not have been made until mid-August; and reimbursement to CVAG from Caltrans would have been much later. Even ignoring the prior, original contract signed by SSG, all reimbursement then occurred subsequent even to July 26, 2000, the date of the last signature on the oldest produced contract signed by all parties.

The extension of the contract for an additional term (March 1, 2001 through May 31, 2001) was approved by the legislative body on February 26, 2001. By virtue of that approval, the "contract" for the third term existed on February 26, 2001. Further, such an extension is a mere "supplement" that did not even require a formal, signed document. As stated in the Manual, "Supplemental agreements are required for modification in the terms of the original agreement to provide changes such as extra time" Much like a change order, "Supplemental agreements shall be approved by the local agency prior to the performance of the work." CVAG has previously provided the documentation to demonstrate that the supplement for the third term was "approved

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by the local agency prior to the performance of the work." The first invoice for this term was not received by CVAG until June 14, 2001. Necessarily, then, there was no reimbursement to SSG by CVAG, or to CVAG by Caltrans, until long after April 10, 2001, the date of the last signature on the contract form. In any event, further documentation for this term is outside the three-year retention period.

Similarly, the contract was supplemented to extend the term ending date from May 31, 2001 to the end of June 2001 by formal action of the agency on June 4, 2001. The last invoice for this term was received by CVAG on July 30, 2001, so that the three-year record retention period expired July 30, 2004. Irrespective of the retention period, there was no reimbursement to SSG by CVAG, and no reimbursement to CVAG by Caltrans, until after the original invoice received by CVAG on July 30, 2001. As the supplement was approved on June 4, 2001, the reimbursement postdated the supplement. Under any analysis, at a maximum there was only a 3 day gap between the expiration of the third term and the approval of the supplement extending the term by an additional month. As noted above, the Manual allows such a supplement by agency approval.

The supplement whereby the term was extended for the additional period of July 1, 2001 through June 30, 2002 was approved by the agency on July 30, 2001. Even if the first contract, creating a term through the date of a Notice of Completion, is ignored, there is a 29-day gap between the expiration of the prior term and the approval of the extension. However, CVAG did not receive an invoice for reimbursement for this term until August 31, 2001; payment would not have been made until sometime after September 30 – well after the extension of the term was approved by the agency, and after the last dated signature (of the Executive Director two months after the Chair had already signed) on the formal contract agreement.

The supplement extending the term for the period of July 1, 2002 through June 30, 2003, was approved by CVAG on June 3, 2002 and was executed by everyone except the Executive Director prior to July 1, 2002. The first invoice under this supplement was not received until November 25, 2002. Thus, no reimbursement was made prior to the approval and/or execution.

A supplement adding the term of July 1, 2003 through July 31, 2003 was approved on June 30, 2003. Again, in the absence of any statute or ordinance mandating the form, the Executive Director's signature on July 16, 2003 was not necessary to make the supplement effective. The first invoice for this period was not received by CVAG until September 4, 2003, so that no reimbursement was made prior to the supplement being in place.

At the July 28, 2003 meeting the Executive Committee approved a further supplement of an automatic extension of the term subject to a 30-day clause (to allow continued service while CVAG worked on a new RFP for the program). The first invoice for any period within the automatic extension is dated September 23, 2003, such that no reimbursement could have been paid until after the date of the subsequent extension described in the following paragraph.

By formal action at the September 29, 2003 meeting, CVAG approved a formal supplement to the contract for the final term of October 1, 2003 through June 30, 2004, subject to termination upon 60 days notice. The first invoice during that term is dated October 21, 2003, such that reimbursement would not have been made prior to July 26, 2000, the date that the Executive Director signed the formal agreement.

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In sum, in the absence of any statute or ordinance mandating the form of contract entered into by the joint powers agency, a contract comes into existence upon the approval of the terms by CVAG's legislative body. This is a legal distinction, not a factual one as characterized by the Draft Audit. Irrespective of the Department's position with respect to the date the contract came into effect, each formal supplement stated a term in the body, which term had been approved by CVAG's legislative body and was consistent with the submitted invoices. In every instance reimbursement was not made until after the date that CVAG had approved the supplement to the contract extending the term. In almost every case, no invoice for reimbursement was even *received* until after the date that the formal supplement was executed. In no event was reimbursement made until after the date that the formal agreement was executed. Accordingly, even if there is no change to the position that the effective date of the contract is the date of the last signature, the asserted gap in the contracts must be narrowed by (a) the applicable three-year retention period and (b) the true gap, if any, between actual reimbursement and the last signature on the formal agreement.

ATTACHMENT V

**INCURRED COST AUDIT OF THE COACHELLA VALLEY ASSOCIATION OF
GOVERNMENTS**

SCHEDULE OF INVALID AGREEMENTS BETWEEN CVAG AND SSG

Attachment V
Revised Schedule of Invalid Agreements and Associated Costs
between CVAG and SSG
November 1, 1999 through June 30, 2004

Period of Agreement	Not Covered	Mos	Operational Reimbursed Costs	Equipment Reimbursed Costs	Total	
No Agreement	N/A	11/1/1999 - 2/28/2000	4.0	\$230,630.04	-	\$230,630.04
3/1/2000 - 2/28/2001	7/26/2000	3/1/2000 - 7/25/2000	5.0	\$323,456.62	590,332.53	\$913,789.15
3/1/2001 - 5/31/2001	4/10/2001	3/1/2001 - 4/9/2001	1.0	\$88,792.74	-	\$88,792.74
No Agreement or Amendment		6/1/2001 - 6/30/2001	1.0	\$68,653.37	-	\$68,653.37
7/1/2001 - 6/30/2002	9/24/2001	7/1/2001 - 9/23/2001	3.0	\$232,527.78	-	\$232,527.78
7/1/2002 - 6/30/2003	7/16/2002	7/1/2002 - 7/15/2002	0.5	41,928.34	-	\$41,928.34
No Agreement or Amendment		7/1/2003 - 9/30/2003	3.0	\$310,501.04	-	\$310,501.04
10/1/2003 - 6/30/2004	11/13/2003	10/1/2003 - 11/12/2003	1.5	136,173.53	-	\$136,173.53
Total Months Not Covered			<u>19</u>			
Total Costs CVAG Reimbursed SSG						
Not Covered By an Agreement			<u>\$1,432,663.46</u>	<u>\$590,332.53</u>		<u>\$2,022,995.99</u>
Less Unallowable Costs included in Finding 1:						
Operational Costs						(1,432,663.46)
Equipment Costs						(31,140.00)
Unallowable Costs to be reimbursed to the Department, Finding 3						<u>\$559,192.53</u>